

3. (a) Define the following terms indicated in bold in the text:

(i) **depreciation (paragraph 5)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is a fall in the value of a currency.

2 *Precise definition* 2

An explanation that it is a fall in the value of one currency in terms of another currency in a floating exchange rate system.

(ii) **consumption (paragraph 5).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is spending by consumers.

2 *Precise definition* 2

An explanation that it is spending by households (consumers) on consumer goods and services.

- (b) Using an AD/AS diagram, explain the likely impact on the UK economy of falling consumer confidence (*paragraph 4*). [4 marks]

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled AD/AS diagram which shows a shift of the AD curve to the left, reducing the average price level and national output or for providing an explanation that consumer confidence is a determinant of consumption which is a component of AD, and that falling consumer confidence leads to a fall in consumption and so a fall in AD and output. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled AD/AS diagram which shows a shift of the AD curve to the left, reducing the average price level and national output and for providing an explanation that consumer confidence is a determinant of consumption which is a component of AD, and that falling consumer confidence leads to a fall in consumption and so a fall in AD and output. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

For AD/AS, the vertical axes may be price level or average price level. The horizontal axes may be output, real output, national output, real national output, national income, or GDP. A title is not necessary.

- (c) Using a business cycle diagram and information from the text, explain in which phase of the business cycle (trade cycle) the UK economy appears to be.

[4 marks]

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled business or trade cycle diagram showing the states of the cycle and indicating a point where the economy is about to reach the peak and then fall into negative values or for providing an explanation that the UK economy is still experiencing positive growth and is about to reach the peak of the cycle and then is likely to move into the start of a recession and towards a trough (or slump). | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled business or trade cycle diagram showing the states of the cycle and indicating a point where the economy is about to reach the peak and then fall into negative values and for providing an explanation that the UK economy is still experiencing positive growth and is about to reach the peak of the cycle and then is likely to move into the start of a recession and towards a trough (or slump). | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

The vertical axes may be labelled GDP, real GDP or total output. The horizontal axes should be labelled time. The labelling on the vertical axes will determine what the cycle looks like and where the correct point asked for is located. A title is not necessary.

- (d) Using information from the text/data and your knowledge of economics, evaluate the consequences for the UK economy if the Bank of England were to raise interest rates from 5% as suggested in paragraph 7.

[8 marks]

Responses **may** include:

Negative consequences:

- may move to a recession (*paragraph 1*)
- consumer confidence will fall further (*paragraph 4*)
- C and I will fall, affecting AD (*paragraph 5*)
- unemployment will increase further (*paragraph 5*)
- household spending will fall as debt repayments increase
- the exchange rate may increase, harming export competitiveness
- rise in business costs, which may cause cost push inflation
- negative wealth effects.

Positive consequences:

- inflation may fall
- an increase in the exchange rate may lead to cheaper imports of raw materials, semi-finished goods, and finished goods, further reducing inflation
- savings may increase.

Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments.

Examiners should be aware that candidates may take a different approach which if appropriate, should be rewarded.

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8